

Feedback statement

on comments received on the draft Opinion on
the supervision of long-term risk assessment by
IORPs providing DC schemes

Policy Department
EIOPA-BoS-21/446
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eioipa

European Insurance and
Occupational Pensions Authority

FEEDBACK STATEMENT

Introduction

EIOPA conducted a public consultation on the draft Opinion on the supervision of long-term risk assessment by IORPs providing DC schemes, which ran from 22 April 2021 until 22 July 2021. EIOPA received 10 stakeholder responses to the public consultation, including a response from EIOPA's Occupational Pensions Stakeholder Group (OPSG), and all of which were public responses.

EIOPA would like to thank all stakeholders for their responses to the public consultation. The input received provided important guidance for EIOPA to finalise the Opinion. All comments submitted were given careful consideration by EIOPA.

This feedback statement summarises the main responses received and how EIOPA addressed them in the Opinion. The individual responses received and EIOPA's feedback on these responses are published in a separate document.

Objective of the Opinion

The Opinion is addressed to the national competent authorities on the basis of Article 29(1)(a) of the Regulation (EU) No 1094/2010. The objective of this Opinion is to enhance supervisory convergence in the supervision of risk management by IORPs providing DC schemes, in particular with respect to operational risk assessment and long-term risk assessment from the perspective of members and beneficiaries, in order to foster the protection of members and beneficiaries and improve the functioning of the internal market.

The aim is to promote efficient and innovative occupational DC schemes with sound investment strategies and risk management that result in optimal long-term risk-return characteristics aligned with the membership structure of the IORP, also in view of the persistent low interest rate environment, taking into account the heterogeneity in occupational DC schemes across Europe.

In only a few Member States, national regulation and/or supervisory guidance supplementing the IORP II Directive address the use of quantitative elements in operational risk management and how DC IORPs should conduct long-term risk assessment from the perspective of members and beneficiaries, also in relation to the establishment of their risk tolerance and the design and review of investment strategies. In consequence, supervisory approaches are currently probably not consistent.

Main responses received and how EIOPA addressed them

The stakeholder reactions to the draft opinion were mixed: some supportive, some seeing positive and negative elements, while others were dismissive. Half of stakeholders agreed with the focus on quantitative elements in operational risk management and long-term risk assessment from the perspective of members and beneficiaries (see Chart 1).

Stakeholders providing a supportive reaction stressed that risks have not vanished in DC schemes and that risk assessment from the perspective of members and beneficiaries is important to protect members and beneficiaries. Such risk assessments are already conducted by IORPs in a number of Member States. These stakeholders also indicated that it is sensible to encourage a quantification of operational risk. Moreover, they appreciated the proportionate and principle-based approach of the opinion.

Chart 1: Do you agree with the focus of the draft Opinion on the quantitative elements in operational risk management and long-term risk assessment from the perspective of members and beneficiaries?, number of respondents

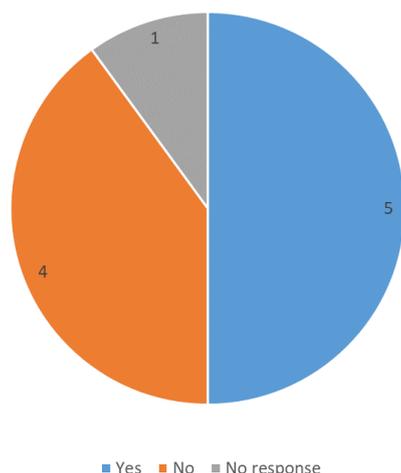
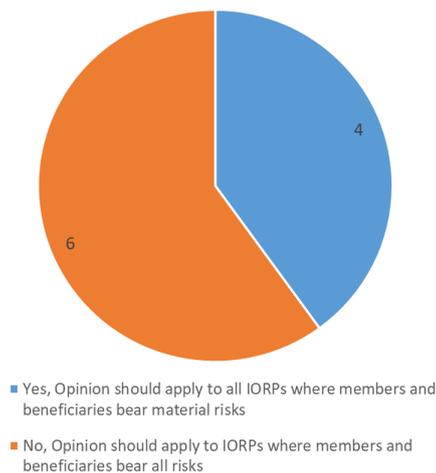


Chart 2: Do you agree with the scope of application of the Opinion, i.e. all IORPs providing schemes where members and beneficiaries bear material risks, or should the scope of the Opinion cover only IORPs providing schemes where members and beneficiaries bear all risks?, number of respondents



Stakeholders being dismissive stressed that EIOPA's aim to achieve supervisory convergence conflicts with the minimum harmonisation approach of the IORP II Directive. A quantification of operational risk and the use of pension projections in risk assessment goes beyond the Directive. According to these stakeholders, even high-level principles may conflict with existing national practices and increase costs. In particular, it was emphasised that national social and labour law and the involvement of social partners will already ensure the protection of members and beneficiaries in some Member States. These stakeholders would have preferred a bottom-up approach by EIOPA, analysing national practices, and subsequently identifying common approaches.

Definition DC and scope of application

Four out of ten stakeholders indicated that restricting the opinion to pure DC schemes would be too narrow and that it should apply to all schemes with material risks (see Chart 2). The other six stakeholders were in favour of limiting the opinion to pure DC plans. They feared that a wider scope would lead to double risks assessments for intermediate DB-DC schemes: one relating to the guaranteed part of the scheme and one to the part where members and beneficiaries bear risks. These stakeholders also stressed that EIOPA should not alter the definition of DC, deviating from national and international definitions.

EIOPA FEEDBACK

EIOPA agrees that it is important to use a consistent definition of DC schemes. As such, the definition of DC schemes was modified in accordance with the definition used by EIOPA in the regular information requests regarding provision of occupational pensions information, which refers to the corresponding OECD definition. At the same time, the opinion specifies that it also applies to other schemes where members and beneficiaries bear material risks. This is in line with the IORP II Directive, which provides that, e.g. in Article 25, where members and beneficiaries bear risks, the risk management system should also consider those risks from the perspective of members and beneficiaries.

Accommodating stakeholders' feedback, it is explained that materiality is determined based on an analysis by the NCA and that NCAs should apply the opinion to other pension schemes in a way that is proportionate to the risks borne by members and beneficiaries.

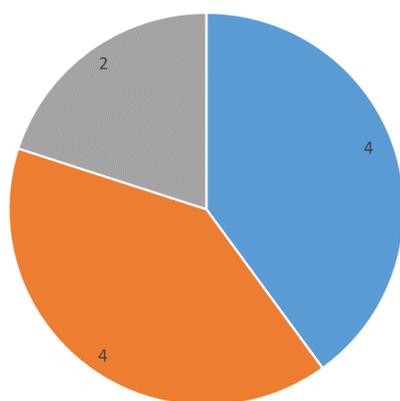
Quantitative elements operational risk assessment

Four stakeholders agreed that the use of quantitative elements in operational risk assessment should be encouraged, while four stakeholders disagreed (see Chart 3). Proponents argued that quantifying operational risk would contribute to a more objective view of operational risk exposures and that the suggested approach is already commonly used and applied. Opponents emphasised that the IORP II Directive only requires a qualitative assessment and that quantification can be complex, costly and be subject to assumptions and uncertainty. Some argued it could even be misleading by hiding extreme outcomes.

Stakeholders argued that any quantification of operational risk should apply to both the internal and the outsourced activities to ensure an equal treatment and to avoid meaningless assessments

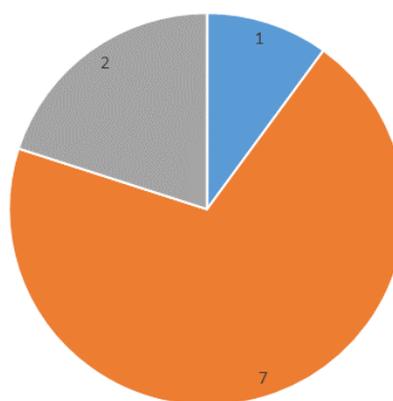
when activities are to a large extent outsourced. There was agreement among stakeholders that quantification cannot be a substitute for a qualitative management of all aspects of operational risk.

Chart 3: Do you agree that the use of quantitative elements in operational risk assessment should be encouraged?, number of responses



■ Yes ■ No ■ No response

Chart 4: Are in your view the Value at Risk (VaR) formulas presented in the annex helpful for better understanding the possible quantitative impact of operational risk exposures of DC IORPs?, number of responses



■ Yes ■ No ■ No response

Most stakeholders disagreed that the Value at Risk (VaR) formulas in the annex of the opinion would contribute to a better understanding of the possible quantitative impact of operational risk exposures (see Chart 4). It was commented that the VaR formula could be used, but that there are also other ways to estimate the quantitative effects of operational risk, e.g. by means of a bottom-up rather than top-down approach. Moreover, stakeholders emphasised that the formula does not capture IORP specificities, most notably risk-mitigating mechanisms. Stakeholders argued that IORPs should have the freedom to use their own models or that the quantification of operational risk should be left to the NCAs.

EIOPA FEEDBACK

In EIOPA's view, the opinion provides sufficient leeway to NCAs and IORPs to encourage the use of quantitative elements in operational risk management, allowing for DC IORPs' own custom-made estimates or the standard formula and recognising that the frequency and severity of operational risks may be hard to quantify. Some specific feedback is taken into account by removing the provision that quantification of operational risk applies at least to

internal activities and by specifying that the assessment should consider any risk-mitigating mechanisms.

Pension projections

Five stakeholders agreed that the risk assessment from the perspective of members and beneficiaries should include a long-term assessment using projections of future retirement income (see Chart 5). One stakeholder explained it to be self-evident that a risk assessment from the perspective of members and beneficiaries will have to consist of long-term pension projections. These stakeholders also mentioned that the use of deterministic or stochastic pension projections is already common practice in many Member States, for the purpose of risk assessment and/or information provision to DC members.

Given national differences and the minimum harmonisation approach of the IORP II Directive, the stakeholders opposing the use of pension projections argued that this should be decided by Member States, NCAs or IORPs. Some stakeholders put forward that such a risk assessment should be optional for DC schemes which consider the risks for members and beneficiaries by design. According to them, it is not the competence of IORPs to question the plan design of sponsors / social partners, while the benefits would be unclear in this case.

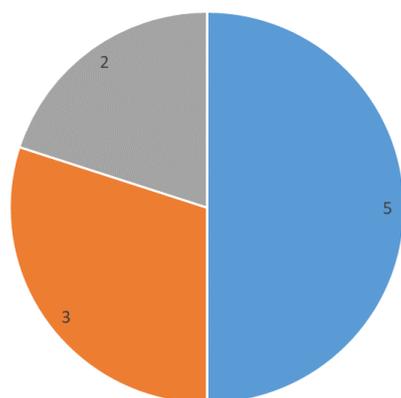
EIOPA FEEDBACK

In EIOPA's view, the use of pension projections in risk assessments from the perspective of members and beneficiaries is in line with the IORP II Directive. According to Article 28, IORPs should include in their own-risk assessment (ORA) "an assessment of the risks to members and beneficiaries relating to the paying out of their retirement benefits [...]". Moreover, it is recognised that social partners can play a valuable role in the design of occupational pension schemes to protect the interests of members and beneficiaries. However, such a role does not relieve IORPs from the provisions laid down in the IORP II Directive, i.e. assessing the risks from the perspective of members and beneficiaries and investing assets in their best long-term interest, taking into account the IORP's membership structure.

Many stakeholders referred to information provision to members and beneficiaries to support their arguments in relation to the use of pension projections. EIOPA clarified in section 2 of the opinion that the expectations are made in the context of DC IORPs' risk assessment and not in relation to the provision of information to members. Still, the information contained in

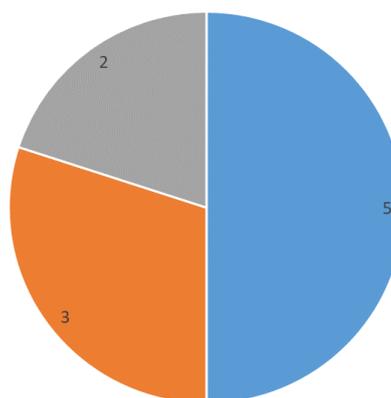
risk management documents, the statement of investment policy principles (SIPP) and information disclosure documents for members should be consistent.

Chart 5: Do you agree that the risk assessment from the perspective of members and beneficiaries should include a long-term assessment using projections of future retirement income?, number of responses



■ Yes ■ No ■ No response

Chart 6: Do you agree that the design and the periodical review of the investment strategy, or investment strategies in case of multiple investment options, should consider the long-term risk assessment using projections of future retirement income, taking into account their risk tolerance?, number of responses

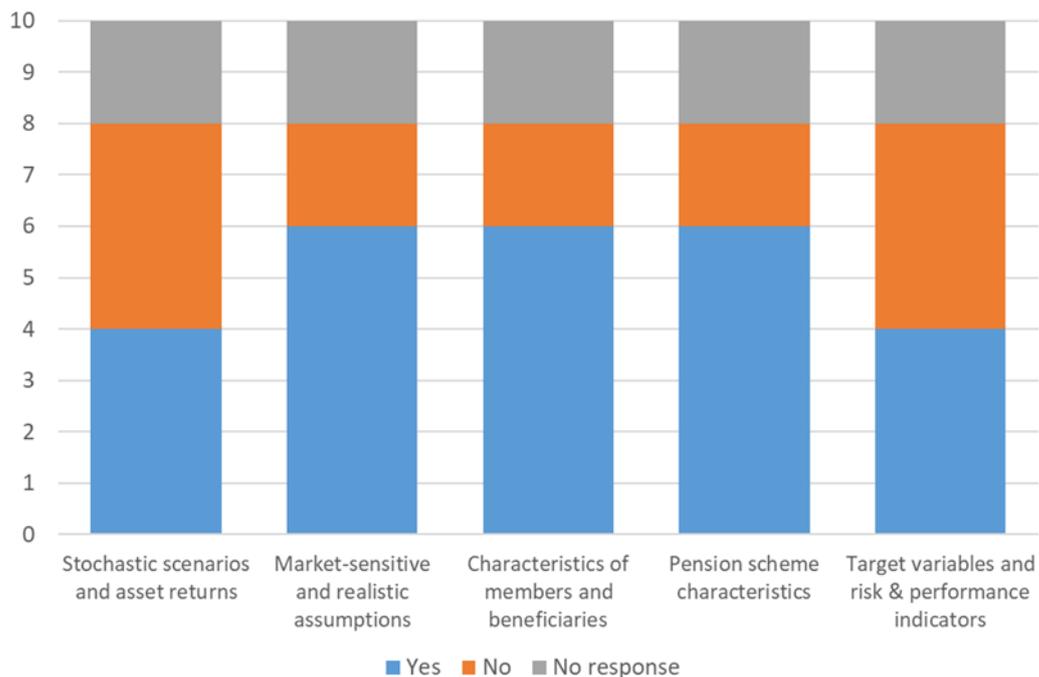


■ Yes ■ No ■ No response

Principles for risk assessment using pension projections

The majority of stakeholders agreed with the principles on market-sensitive and realistic assumptions and taking into account the characteristics of members and beneficiaries as well as the nature of the pension scheme (see Chart 7). The views on the principles on deterministic-stochastic scenarios and risk-performance indicators were more diverse. The draft opinion considered stochastic scenarios to be the default and deterministic scenarios a simplification. A number of stakeholders argued that deterministic scenarios should also be fully accepted as a means to making projections of future retirement income, given that stochastic scenario are more complex, costlier and more prone to error.

Chart 7: Do you agree with the content of the below principles, as put forward in the draft Opinion?



EIOPA FEEDBACK

EIOPA revised the opinion to allow for the use of both deterministic and stochastic scenarios for pension projections, explaining the advantages and disadvantages of both approaches. A disadvantage of deterministic scenarios – where there is no underlying stochastic return modelling – is that it is not possible to define risk indicators based on a probability distribution. Therefore, the opinion was amended to specify that performance and risk can be assessed by means of a best estimate scenario (as a measure of expected performance) and one or more adverse scenarios (to measure risk).

In addition, some specific stakeholder feedback was taken on board to clarify that:

- ▶ The risk assessment should consider all risks to which members and beneficiaries are exposed;

- ▶ The application of the market-sensitivity principle requires good judgement to avoid that pension projections are based on asset prices and interest rates which are observed during exceptional or stressed market circumstances;
- ▶ Realistic assumptions are not only needed for risk premiums but also for correlations between returns on different asset classes;
- ▶ The assumptions for risk premiums and correlations can, in the absence of current market observations, be based on long-term historical observations.

ASSUMPTIONS WILL BE NEEDED FOR INTEREST RATES AT LONGER MATURITIES, AS OBSERVATIONS MAY NOT BE AVAILABLE IN DEEP, LIQUID AND TRANSPARENT MARKETS.

Interaction with investment strategy, taking into account the risk tolerance

Half of stakeholders agreed that the design and the periodical review of the investment strategy, or investment strategies in case of multiple investment options, should consider the long-term risk assessment using projections of future retirement income, taking into account their risk tolerance (see Chart 6). Three stakeholders disagreed because in their view IORPs / NCAs should decide on whether to use pension projections in the risk assessment from the perspective of members and beneficiaries. Moreover, the argument was made that this would be redundant in some Member States since social partners already decide on the investment strategy.

One stakeholder commented that default investment strategies / options are insufficiently covered in the draft opinion.

Nearly all stakeholders agreed with the approach taken by the opinion to recognise and allow different methods to establish the risk tolerance of the DC IORP's membership (see Chart 8). Stakeholders felt it was important that IORPs gain insight in the risk tolerance and take this into account in the investment strategy, especially where the IORP provides a default option. However, a one-size-fits-all approach is not possible, also considering that a generally accepted methodology is not available. Moreover, some stakeholders indicated that surveying individual DC members may be challenging due to a lack of financial expertise / literacy. As such, according to some stakeholders, it may be preferable to establish the risk tolerance indirectly through member representatives or social partners.

Most stakeholders indicated that a frequency of at least every three years for conducting the risk assessment using pension projections would be sufficient, unless there is a significant change in the risk profile. This is in line with the frequency for the periodical review of the SIPP and the conduct of the ORA prescribed in the IORP II Directive.

Chart 8: The supervisory expectations recognise and allow different methods to establish the risk tolerance of DC members and beneficiaries. Do you agree or would you propose more specific guidance?, number of responses

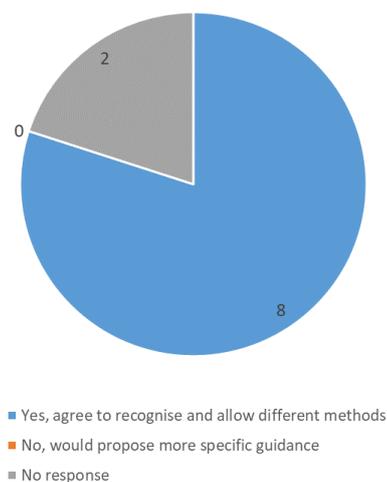
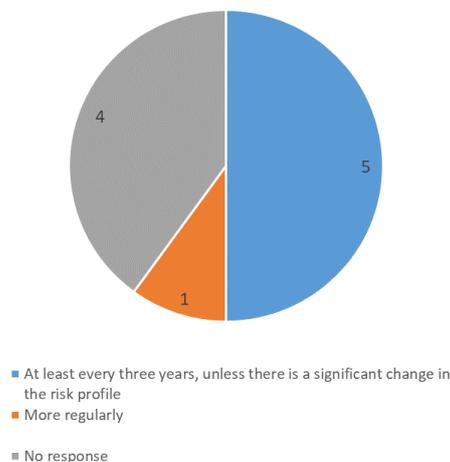


Chart 9: What should in your view be the frequency of conducting the risk assessment using pension projections?, number of responses



EIOPA FEEDBACK

Explanatory text was added to emphasise that the proposed long-term risk assessment framework is particularly important for default options, in which DC members are automatically enrolled (if they fail to make an active choice). However, the framework will also be relevant for investment options that rely on members’ choice by helping DC IORPs to design and review a range of investment options that are suitable for the membership, taking into account their risk tolerance.

National specificities and proportionality

Stakeholders raised most concerns about the draft opinion recognising national specificities and achieving a proportionate approach. Five stakeholders disagreed that the principles in draft opinion for conducting projections of future retirement income strike the right balance between setting sensible minimum standards and recognising the specificities of DC schemes in the various Member States (see Chart 10). Seven stakeholders replied that the draft opinion did not achieve a proportionate approach to DC risk management, fitting small-, medium- and large-sized IORPs (see Chart 11).

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Chart 10: Do the principles for conducting projections of future retirement income strike the right balance between setting sensible minimum standards and recognising the specificities of DC schemes in the various Member States?, number of responses

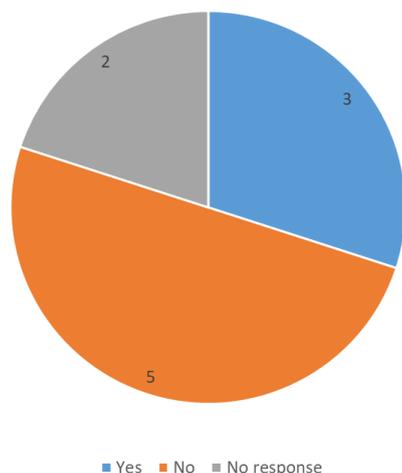
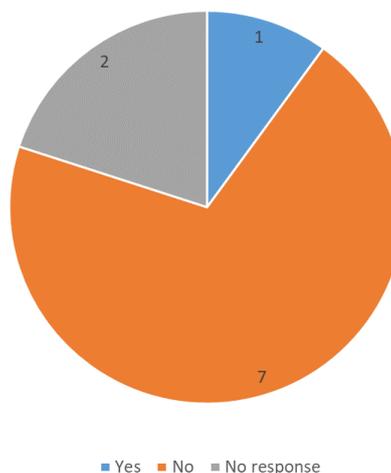


Chart 11: Do the expectations put forward in the draft Opinion achieve a proportionate approach to DC risk management, fitting small-, medium- and large-sized IORPs?, number of responses



A number of stakeholders put forward the general concern that the expectations contained in the draft opinion go beyond the provisions in the IORP II Directive. According to them, the aim of supervisory convergence conflicts with the minimum harmonisation approach of that Directive as well as national regulation and supervision. As such, these stakeholders argued that the demands on operational risk assessment and risk assessments from the perspective of members and beneficiaries are the responsibility of Member States, NCAs and IORPs.

While some expressed appreciation for the proportionate and principle-based approach, others put forward that EIOPA should not propose uniform models, also emphasising that PEPP should not become the de facto standard. In particular, as mentioned above, stakeholders emphasised that stochastic scenarios should not be considered the default way of making pension projections, but treated on an equal footing with deterministic scenarios.

Part of stakeholders responded that risk assessments using pension projections would be superfluous because national social and labour law (SLL) already ensures the protection of members and beneficiaries. In particular, social partners may be involved in the design of DC schemes, already taking into account the interests of members and beneficiaries. Some stakeholders indicated that for IORPs where members and beneficiaries bear only part of the risks, the risk assessment may lead to a double burden, i.e. both a risk assessment from the perspective of IORPs and of members and beneficiaries. Moreover, it was suggested that proportionality has to be assessed at the level of implementing the opinion.

Although four stakeholders agreed that the cost-benefit analysis in the draft opinion provided a balanced view of the costs and benefits, other stakeholders argued that a more in-depth analysis is needed, also further analysing the specificities of DC schemes across Europe.

EIOPA FEEDBACK

EIOPA would like to reiterate that Article 29(1)(a) of the Regulation (EU) No 1094/2010 requires EIOPA to play an active role in building a common Union supervisory culture and consistent supervisory practices, as well as in ensuring uniform procedures and consistent approaches.

In enhancing convergence in the supervision of long-term risk assessment by IORPs providing DC schemes, the opinion closely follows the provisions of the IORP II Directive in this area. Most notably, the Directive already specifies that IORPs, providing schemes where members and beneficiaries bear risks, should assess the risks to members and beneficiaries relating to the paying out of their retirement benefits. Moreover, IORPs have to invest assets in the best long-term interests of members and beneficiaries, implying an investment policy geared to the membership structure of individual IORPs.

For the purpose of supervisory convergence, the opinion puts forward an integrated view of how the requirements in the IORP II Directive are interrelated, i.e. risk-assessment from the perspective of members and beneficiaries, establishment of the risk tolerance and the design and review of investment strategies. In addition, the opinion encourages quantitative elements in operational risk management and sets high-level principles for conducting pension projections and establishing the risk tolerance of members and beneficiaries.

EIOPA made a couple of amendments to the draft opinion to ensure a proportionate approach. As mentioned earlier, NCAs may allow both deterministic and stochastic pension projections. Moreover, the opinion expects NCAs to apply the opinion to other schemes where members and beneficiaries bear material risks, taking an approach proportional to those risks.

EIOPA agrees that achieving a proportionate approach will depend on the way the opinion is integrated in national supervision. In that respect, the opinion specifies that CAs may take into account national specificities of the IORP sector to determine the requirements necessary for implementing this Opinion, applying a risk-based and proportionate approach.

EIOPA improved the cost-benefit analysis accompanying the opinion, also providing more detail on the NCA survey on national practices that was conducted in 2021. The impact assessment shows more clearly how the principle-based approach taken by the opinion

compares with a more uniform approach, like in PEPP. The conclusion is that such a principle-based approach provides the best balance between enhancing protection of members and beneficiaries and limiting the impact on national IORP systems. This is in line with the aim to promote the provision of efficient occupational DC schemes with sound investment strategies and risk management that result in optimal long-term risk-return characteristics aligned with the membership structure of IORPs.

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